BENEFITS AND PENSIONS MONITOR MEETINGS & EVENTS WEBINAR

Inflation, recession and bonds... Sébastien Mc Mahon helps you see the full picture!

The behaviour of the global economy in 2022 was actually predictable, says Sébastien Mc Mahon, Chief Strategist and Senior Economist at iA Financial Group in the Benefits and Pensions Monitor 'Inflation, Recession, and Bonds…Sébastien Mc Mahon helps you see the full picture' session. With 2020 the year of the virus and 2021 the year of the vaccine, "we thought 2022 was the year of uncertainty. Now we realize it was the year of the hangover from the effects of saving the economy from the first pandemic in 100 years." The "medicine" administered to the economy was governments stopped sending money to households to keep the economy going. Central banks also hiked interest rates to help save the economy.

So, inflation was expected. However, it wasn't expected to be as strong as it is. Russia invading Ukraine was a surprise that pushed inflation higher.

Now, of course, "inflation is all over this picture." Although it probably peaked in June at seven per cent in Canada, the fight is not over.

Types Of Inflation

Since early 2020, there have been several types of inflation.

During the pandemic, it started with cost push inflation, which is when supplier prices rise forcing the price of products higher.

One source of supplier price increases was the cost of shipping. It became problematic because there were some regions like China that were closed. Logistics became complicated and companies like Wal-Mart and Target were outbidding each another to get shipments first. The result was the price of transportation multiplied by 15.

"When you look at current prices, this is normalizing so this is likely behind us," Mc Mahon said.

Higher demand prompted the second round of inflation. Money went to households to keep the economy going and lower interest rates made it easier to borrow to buy. COVID lockdowns meant spending on services dropped so households created more demand for goods.

However, inflation starts "taking a bite out of spending power." As prices rise, inflation expectations rise.

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These expectations can persist even when the reality is different. Economists expect inflation to fall from seven per cent to about 3.5 per cent over the next 12 months. However, households expect it to continue to be seven per cent. This is prompting employees to seek higher raises and businesses to sign contracts with suppliers that include protection against higher inflation, so 'it becomes self-fulfilling," Mc Mahon said, and "it's a spiral that central banks do not want to see." Central banks create recessions to slow the economy down enough to break the back of inflation expectations and make sure everything remains stable.

"It's been proven time and time again that if inflation is positive, but small and stable, the optimal conditions to have sustainable growth result. That's what they want to achieve."

The opposite is what Japan went through over the last two decades. If inflation is high, "people tend to wait to buy a brand new TV. If I wait one year, probably the price will be lower than today," said Mc Mahon.

Companies also postpone investments expecting lower prices. "That's how you fall into a stagnating economy."

And while strong inflation can result in year-over-year growth in wages, "when you adjust for inflation, the average earnings of Canadian households has been contracting for a while. There's a loss of spending power." A large part of the population won't ever be able to make up for that loss of spending power. It becomes an inequity issue for any economy and it has been shown strong bouts of inflation have a bigger impact on the well-being of the population than recessions do. "That's why inflation that's volatile, that's elevated, is not something that we want," he said.

Shallow Recession

Around the world, the odds of a recession are high. However, this could be a shallow recession because of the tight labour markets. In the U.S., there's about two jobs available for every unemployed person. In Canada, it's 0.7 jobs available per unemployed.

In a typical recession, consumer and investment spending are the first variables to show signs of weakness. Slower demand means there's less production, less production leads to job cuts. and then, incomes fall and "you spiral down into a recession."

Mc Mahon concludes, "Maybe this time, if we don't have the massive job cuts, we could have a shallow recession, a recession that won't be as hurtful as some that we've seen in the past." **BPM**

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